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ANAND GOEL

Swipe Up

Reducing payment fees isn't just a fad

U.S. merchants will spend over $90 billion in credit card processing or swipe fees in 2019. For many organizations, swipe fees represent one of their top five operating costs. Swipe fees continue to grow, not only due to an increase in card sales, but also due to increases in interchange and network fees. Just this spring, Visa and MasterCard announced significant increases in certain interchange categories and cross-border fees. Some merchants will see their swipe costs increase by up to five percent from 2018 to 2019 simply due to fee increases. This is not to mention the additional costs created by upgrading POS systems and payment terminals, adding a security solution (e.g. encryption, tokenization, fraud) and implementing omnichannel strategies (e.g., endless aisle, global tokens).

It has become imperative for treasury leaders to reign in out-of-control card processing costs. Passive management of this expense category isn't an option for organizations seeking efficiencies and competitive advantage. Managing swipe fees is a process like any other process inside a company. And like any process, it can be made more efficient by measuring and optimizing all the components in the (payments) value chain. Our guidance below relies upon 200-plus consulting engagements with merchants processing $100 million or more in card sales per year.

Interchange fees – Optimize and negotiate

For most organizations, interchange fees or fees paid to card issuers, comprise the single largest component (about 85 percent) of the total cost of processing card transactions. If the cost of card acceptance is 2.00 percent, then about 1.70 percent goes to the bank that issued the card.

Interchange revenues pay for the cost of money (the bank provides an interest free loan, to a person's credit limit, if the card balance is paid in full), rewards programs, internal costs including fraud, and profit. There are two ways to measure and optimize interchange. First, merchants should measure their downgrade ratio, or percentage of sales receiving suboptimal interchange rates. Any given retail or e-commerce transaction is subject to four or more different published interchange rates, based on submission timeliness and data elements sent with authorization and settlement records.

For instance, if the POS entry mode or transaction amount do not match in the authorization request and settlement file, then the transaction will downgrade and be subject to higher interchange fees. The target downgrade ratio for merchants is 2.0 percent or less—anything above requires attention. Fixing downgrades could save hundreds of thousands to millions of dollars in unnecessary costs.

A second way to measure and optimize interchange is to negotiate custom or lower interchange rates with Visa, MasterCard, Discover and PIN debit networks. There are many merchants who have VPP (Visa Partner Program) and MPP (MasterCard Partner Program) incentive agreements, along with agreements with Interlink, Maestro, NYCE, Pulse, STAR, and other PIN debit networks. Merchants with significant card sales, generally billions of dollars per year or millions of transactions, have the ability to negotiate either lower interchange rates and/or quarterly rebates for credit, signature debit and PIN/PINless debit sales.

Critical to these negotiations is a merchant's sophistication (e.g., understanding of similar agreements in the industry), a merchant's own card volume growth potential and a merchant's ability to shift volume amongst different debit networks. This last element can play an outsize role if a merchant or its processor can route debit transactions to the lowest cost or preferred network. Of course, merchants can also negotiate with American Express. Instead of negotiating interchange, merchants are negotiating discount rates. Similarly, critical to negotiating with American Express is the merchant's sophistication, their AmEx card volume growth potential and AmEx's pricing competitiveness.

Network fees – Audit and optimize

The second largest expense of card processing is network fees, which comprise about 10 percent of the total cost of card payments. These fees serve as revenue for Visa, MasterCard and Discover. They are charged both as a percentage of sale and per transaction.

There are two opportunities to optimize these fees. First, merchants should audit them to ensure that they aren't artificially inflated by their processor and merchants are in fact, paying published network fees. Some acquirers and ISOs/resellers tend to markup network fees for interchange pass-through merchants. This practice is unethical, perhaps illegal, but it does occur in the marketplace. In the last two years, two class action law suits have been settled against Mercury Payment Systems and North American Bancard/Global Payments for such practices. A merchant should validate every network fee and seek clarification from their processor of any ambiguous charges. Merchants are eligible for refunds for inflated fees and overcharges.

The next opportunity to reduce network fees is to eliminate any transaction integrity fees. Visa and MasterCard's additional fees ranging from $0.055 to $0.20 per transaction when an authorization doesn't have a corresponding settlement transaction, or when a settled transaction doesn't have a corresponding authorization. The industry best practice is 1. to always authorize every transaction and 2. reverse or partially-reverse any authorizations that will not be settled. To validate a card, merchants should utilize zero-dollar authorizations.

Acquiring and gateway fees – Benchmark and negotiate

The final component and expense of card processing is acquiring and gateway fees that comprise about 5 percent of the total cost of card payments. Acquiring and gateway services may come from one or two providers. In either case, all acquiring and gateway fees are negotiable. The best practice is to perform a merchant services RFP every three to four years to not only benchmark fees in the marketplace, but also to learn about the latest payments products and solutions. We have dealt with many merchants who have had the same acquiring

contract for the last 10 to 20 years. Merchant acquiring is hypercompetitive, and it would be incumbent upon every treasury leader to benchmark fees.

When negotiating with acquirers, it is helpful to know what your peers are paying for the same type of services. However, this type of information is not readily available and may require the use of a specialized consultant or consulting firm. Such third parties have exposure to broader data sets and industry insights that can prove valuable. If a merchant does not have internal resources, outside consulting experience could prove to be highly beneficial in all of the initiatives outlined above.

Payments analytics

Benchmarking, negotiating and optimizing interchange, network, acquiring and gateway fees shouldn't be just a one-time exercise. It should be an ongoing process that is regularly monitored, measured and optimized. A time and cost-effective way to achieve this goal is to implement payment analytics. This is a systematic approach of consuming and analyzing data, whether daily, weekly or at minimum, on a monthly basis. There are so many nuances and variables that impact the cost of card payments that a structured analysis is warranted. As you know, it is hard to improve a process if it cannot be analyzed.

AFP 2019

Bringing all of these elements together at AFP 2019 in Boston, an educational session titled 'Reducing Payment Fees Isn't Just a Fad' will delve into best practices used by Tiffany & Co and Kering Americas (parent of luxury brands like Gucci, Saint Laurent, Bottega Veneta, Balenciaga, Alexander McQueen and Brioni). I'll be moderating this session, and you'll hear from treasury leaders of these iconic, global brands as they share their framework and journey on optimizing payments. They will share their perspective on many topics, including merchant services RFPs, consolidating providers, interchange optimization, alternative payments, reconciliation, and BIN analysis to better understand customers.

Remember, the payments optimization journey isn't complete for Tiffany & Co and Kering, but they have made significant progress in the last few years. Treasury and finance leaders should attend this session to learn about payments successes, failures and priorities for the future of these organizations. Session attendees will also have an opportunity to ask questions.

Anand Goel is CEO of Optimized Payments Consulting. Don't miss his AFP 2019 session, Reducing Payment Fees Isn t Just a Fad in the Payments track.

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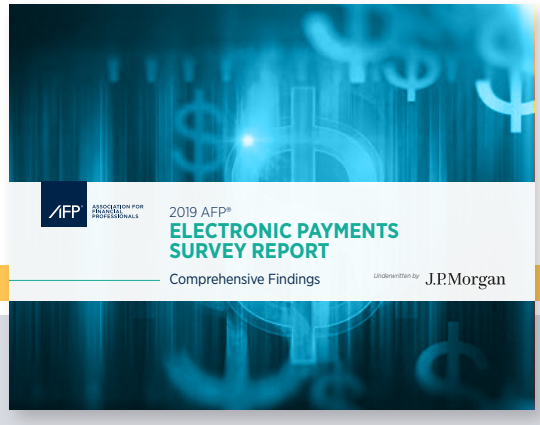

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